APPENDIX.

STATUTES INVOLVED.

U. S. C., Tit. 12, §§ 91 and 194, in so far as here material:

"§ 91. **Transfers by bank and other acts in contemplation of insolvency.**

"All transfers of the notes, bonds, bills of exchange, or other evidences of debt owing to any national banking association, or of deposits to its credit; all assignments of mortgages, securities on real estate, or of judgments or decrees in its favor; all deposits of money, bullion, or other valuable thing for its use, or for the use of any of its shareholders or creditors; and all payments of money to either, made after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application of its assets in the manner prescribed by this chapter, or with a view to the preference of one creditor to another, except in payment of its circulating notes, shall be utterly null and void;".

"§ 194. **Dividends on adjusted claims; distribution of assets.**

"From time to time, after full provision has been first made for refunding to the United States any deficiency in redeeming the notes of such association, the comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated;".

Office - Supreme Court, U. S.
FILED
MAY 8 1942
CHARLES ELMORE CROPLEY
CLERK

(23)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 1146.

DAVENPORT HOSIERY MILLS AND UNITED HOSIERY MILLS,
Petitioners,

v.

J. BUCKNER FISHER, RECEIVER OF THE CHATTANOOGA NATIONAL BANK, *Respondent.*

RESPONSE TO PETITION FOR CERTIORARI.

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Of Counsel.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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RESPONSE TO PETITION FOR CERTIORARI.

STATEMENT OF THE CASE.

This suit was brought by the Receiver of the Chattanooga National Bank, an insolvent national banking corporation, against the defendants, (who are depositors of said bank), for allegedly excessive withdrawals constituting an illegal preference to these defendants, the withdrawals having been made during the so-called banking holiday of 1933 proclaimed by the President of the United States. The Chattanooga National Bank will be referred to herein as the "Bank"; the Davenport Hosiery Mills, Inc., and the United Hosiery Mills, as the "Mills."

The Bank closed its doors as of the close of business for the day, on March 1, 1933, pursuant to a proclamation of the Governor of Tennessee, and did not thereafter reopen for regular banking business. (R. 31 and 32)

From March 1, 1933 until 3:00 a.m. on the morning of March 14, the officers and directors of the Bank were feverishly, and valiantly attempting to make arrangements to reopen the Bank in anticipation of the expected expiration of the banking holiday proclaimed by the President on March 6th. Its cash position was not good. Efforts were made to obtain loans, both from the Reconstruction Finance Corporation and from the Federal Reserve Bank, but the commitments which these institutions made were not as large as the officers and directors hoped they might be. Nevertheless, the Bank did make application for a license to reopen (R. 26), which application was granted, and a license accordingly issued. (R. 27) After a careful review of the entire situation, however, the executive committee of the Bank, at 3:00 a.m., March 14, the date when it was authorized to reopen, decided to recommend to the directors that the Bank not reopen, and that a Conservator be appointed. (R. 54-57) Z. C. Patten, a director of the Bank, was appointed Conservator (R. 59) and served until November 6, 1933, when Paul J. Kent was appointed Receiver. (R. 34 and 35) These suits were originally instituted in the name of the Receiver, Kent, but were later revived in the name of his successor, J. Buckner Fisher. (R. 186)

Believing that the Bank would reopen on March 14, it was open upon a restricted basis from March 10 to March 13, inclusive, in asserted reliance on Treasury Regulation No. 10 (R. 43), during which time it cashed four checks of petitioner, Davenport Hosiery Mills, totaling $18,574.65, by paying scrip of the face value of $18,274.00 and cash in the amount of $300.65. (R. 35, 36, 37) Copies of the checks totaling the above amount are filed as Exhibits. (R. 69, 70 and 71) In the case of the United Hosiery Mills it was stipulated that if respondent was entitled to recover anything the amount was $892.79, which is the amount of the

checks cashed by it, less dividends retained by respondent. (R. 86)

The dates from March 10 to March 13, 1933, inclusive, were the only dates that the Bank was open for any purpose from the time it closed on March 1 until the Conservator was appointed on March 16, and on these dates the Bank was open only for the purpose of transacting such business as was authorized by the said Treasury Regulation No. 10. The substance of Treasury Regulation No. 10, in so far as it applies to this case, is that Banks whose financial situation permitted them to do so might exercise their usual banking functions to meet the needs of the community for food, medicine and other necessities of life, for the relief of distress and for the payment of salaries and wages, etc. The Regulation further provided that no bank should engage in any transaction which was violative of any Federal Law or of any order issued by the Comptroller of the Currency. The scrip which the Bank issued to these petitioners when it cashed their checks reads as follows:

"Chattanooga National Bank,
Chattanooga, Tennessee.

Five dollars of a deposit in the Chattanooga National Bank of Chattanooga, Tennessee, has been assigned by the depositor thereof to the bearer hereof. The Chattanooga National Bank of Chattanooga has accepted this assignment and agrees to credit the account of the bearer in said bank with said amount upon the presentation hereof. Any credit in said bank created by presentation of this assignment to the credit of bearer is subject, at the option of said bank, to the issuance of like assignments for a period of six months from the date hereof.

This March 10, 1933.

(Signed) Chattanooga National Bank,
W. H. DeWitt, Cashier" (R. 61).

At a meeting of the Directors on March 9, 1933, the Bank was authorized to issue scrip and the officers of the Bank were authorized to pledge assets of the Bank as security

for the redemption of scrip (R. 64, 65, 66). On the following day,—March 10, 1933,—the Bank executed a trust agreement, under the terms of which it transferred and assigned to the First National Bank of Chattanooga as Trustee securities belonging to the Bank of the face value of $250,097.69. The instrument provided that the said securities were pledged for the purpose of fully satisfying in cash the scrip which the bank was to issue. The First National Bank of Chattanooga accepted the trust and acknowledged receipt of the securities totalling $250,097.69. (R. 66, 67 and 68)

J. H. Davenport, President of the Davenport Hosiery Mills, (Cause No. 2188), **was also a director of the Bank,** and attended and participated in the Bank's directors' meeting which authorized this unlawful pledge of the Bank's assets. (R. 105, 107, 108 and 65) The public, through the press, was advised that the payment of the scrip was amply secured and that it would be redeemed in cash at its face value. (R. 172, 173, 174, 175, 176)

When these securities were taken out of the general assets of the Bank and pledged to the First National Bank of Chattanooga as Trustee for the purpose of securing the redemption in cash of all scrip issued by the Bank only to those depositors who could qualify under the provisions of Treasury Regulation No. 10, while all other depositors and creditors of the Bank did not enjoy this privilege, an illegal preference was then and there extended to these depositors, including these petitioners. This transaction enabled these petitioners to pay their obligations to their employees out of the assets of the Bank when the Bank had already committed an act of insolvency while the Bank was insolvent.

When the petitioner Davenport Hosiery Mills received the scrip from the bank, after presenting its checks therefor, *it paid all of it to its employees with the exception of $2,751.62 at the full valuation of one hundred cents on the dollar,* and these employees traded this scrip to merchants or other parties whom it is impossible to identify. The

$2,751.62 was deposited by this defendant in the American Trust & Banking Company, which bank treated the deposit as a cash deposit (R. 100, 101 and 102).

The same is true of petitioner, United Hosiery Mills, except that no portion of the scrip it received was deposited, but all of it was paid to its employees at one hundred cents on the dollar, who in turn traded it to merchants or other parties in Chattanooga, treating the scrip as cash (R. 86).

During the dates from March 10 to March 13, inclusive, the Bank issued scrip in the face amount of $117,989.00, of which $18,274.00 worth was issued to petitioner Davenport Hosiery Mills, and a smaller amount was issued to the United Hosiery Mills. Since the issuance of the scrip, the Bank has redeemed all of it in cash with the exception of scrip of the face value of $199.00, but for the redemption of this the Receiver now holds a special account in the sum of $199.00 in cash (R. 37, 38).

Out of the $199.00 of scrip which has not been redeemed, the Bank issued $106.00 to Sam H. Carter upon the presentation of his check therefor and this amount the said Sam H. Carter destroyed (R. 88-92).

It results, therefore, that scrip having a face value of $93.00 is unaccounted for out of the total amount of $117,989.00 issued by the Bank. The facts are that these petitioners have never been called upon to make good any of the scrip issued to them which they, in turn, either paid to their employees, or deposited in another bank, both the bank and the depositor treating it as cash.

By this circuitous and illegal arrangement, these petitioners have been able to obtain assets from the bank, which other depositors were unable to obtain. When called upon to make restitution by paying back an amount sufficient to place themselves on the same basis with other depositors, they refused.

REASONS ASSIGNED IN PETITION FOR GRANTING WRIT. (Pet. 8)

We submit that in this case the Circuit Court of Appeals has decided no new question of law. It has merely reiterated the established law that a bank after committing an act of insolvency shall not prefer one creditor over another.

We submit that the decision of the Circuit Court of Appeals in this case *is not only not in conflict with, but, on the contrary, is in complete harmony with* the reasoning and the conclusions of law laid down by this Court in *National Bank of Newport* v. *National Herkimer County Bank*, 225 U. S. 178, 56 L. Ed. 1042. We will fully discuss this case on subsequent pages of this brief.

We also submit that there is no conflict between the decision of the Circuit Court of Appeals in this case and the decisions of other Circuit Courts of Appeal in the cases cited on page 7 of the petition. Nor is there a conflict with the decision of this Court in *Texas & P. R. Co.* v. *Pottorff*, 291 U. S. 245, 78 L. Ed. 777. The question of the preference of one creditor over another in the distribution of the assets of a national bank in violation of Section 91 and Section 194 of Title 12, U. S. C. was not the controlling issue in these cases. All of said cases deal with a bank's pledge of its assets to secure a deposit while the bank was amply solvent, and long before the commission of an act of insolvency. The pledges were declared void because *ultra vires*. In the instant case the pledge was "utterly null and void" because violative of Section 91, Title 12, U. S. C.

This National bank has been in liquidation for more than nine years. The remaining assets have been sold and final relief can be given depositors as soon as pending litigation is completed. There is no public interest in the questions presented and there is no conflict in decisions to be resolved. The parties had their day in court when their rights were resolved by the two courts below.

The issues presented, and the type of transaction involved, are peculiar to the unusual conditions then existing, and no general administrative policy relating to the liquidation of national banks is presented.

QUESTIONS PRESENTED BY THE PETITION.
(Pet. 2)

The two questions presented by the petition, one referred to as primary and the other as corollary, are as follows:

> "The primary question presented in this petition is whether a depositor of an insolvent national bank who receives no asset of the bank directly or indirectly, but who, for a consideration received from a third party, assigns to the third party a part of the deposit under a certificate issued by the bank providing for such assignment and attempted to be secured by a pledge of its assets, (admittedly void because ultra vires), received a preference in violation of 12 U. S. C., Sections 91 and 194.
>
> A corollary question presented is whether such depositor, by reason of the consideration so received from the third party, is estopped to deny the validity of such ultra vires pledge by the bank."

THE "PRIMARY" QUESTION.

It will be noted that the "pledge of assets" by the Bank is referred to as "admittedly void because ultra vires." Rather was this pledge "utterly null and void" because violative of the express provisions of Section 91, Title 12, U. S. C., and because the pledge of assets and assignment of interests therein by these petitioners prevents and makes impossible a "ratable dividend" to be paid to all creditors as required by Section 194 of the same Title.

The petitioners attempt to split into separate transactions the single transaction evidenced, first, by the Bank's illegal pledge of certain of its assets to redeem in cash the scrip which it issued and, second, the issuance of the scrip itself.

It is impossible to split this single transaction into two separate transactions. One is dependent on the other. Each is an integral part of the other. The issuance of the scrip was authorized at a meeting of the Board of Directors held March 9, 1933, and the Minutes of the meeting show that authority was then granted for the issuance of the scrip and the officers were then authorized to pledge definite security

for the payment of the scrip, which security was taken from the general assets of the Bank (R. 65).

The trust indenture by which the officers and directors attempted to secure the scrip and the scrip itself were both dated March 10, 1933. The securities delivered by the Bank to the First National Bank had a face value of $250,097.69, and the trust indenture provides that the scrip should be paid in cash (R. 67).

This effort of petitioners to split the single transaction into separate transactions, stripping the admittedly illegal portion from what petitioners contend is legal, results in their whole argument being based upon a false premise. A house built upon the sand cannot stand.

Section 91, Title 12 U. S. C. (R. S., Sec. 5242), provides as follows:

> "All transfers of the notes, bonds, bills of exchange, or other evidences of debt owing to any national banking association, or of deposits to its credit; all assignments of mortgages, sureties on real estate, or of judgments or decrees in its favor; all deposits of money, bullion, or other valuable thing for its use, or for the use of any of its shareholders or creditors; and all payments of money to either, made after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application of its assets in the manner prescribed by this chapter, or with a view to the preference of one creditor to another, except in payment of its circulating notes, shall be utterly null and void; and no attachment, injunction or execution, shall be issued against such association or its property before final judgment in any suit, action, or proceeding in any State, county, or municipal court."

The object of this statute is plain. It is to prevent a national bank from preferring one creditor over others under the following circumstances:

(a) After the commission of an act of insolvency;

(b) In contemplation of insolvency;

and with a view to

(1) Preventing pro rata application of assets to the satisfaction of claims of depositors and creditors. Federal Reserve Bank v. Omaha National Bank, 45 Fed. (2d) 511; Brown v. Stronach, 7 F. (2d) 685; Smith v. Baldwin, 69 Fed. (2d) 390, or

(2) Preference of one creditor over another. Ball v. German Bank, 187 Fed. 750; National Security Bank v. Butler, 129 U. S. 223; Hirning v. Federal Reserve Bank, 42 F. (2d) 925; Vann v. Federal Reserve Bank, 47 Fed. (2d) 786.

The petitioners' position is that when they presented their checks and obtained therefor only scrip instead of cash, there was no transfer of assets, no depletion of the assets of the bank, no payments made to defendants, that the certificates were simply partial assignments of accounts in the bank and since the attempted pledge to secure the payment of the scrip was void, the petitioners received only certificates which they could transfer to others who would have to take their chances on the amount of cash which they finally received for the certificates.

The petitioners take this position in spite of the fact that the record shows without dispute that they presented their checks to the bank made out for a certain number of dollars and received therefor scrip in dollar denominations of an amount equal to the amount of the check and that thereafter they treated the scrip as cash, paid it to their employees, whom they persuaded to accept it as cash in full discharge of the employees' claim against the Mills for services rendered, and in spite of the fact that thereafter the employees treated it as cash and paid it to merchants treating it as cash; that the scrip continued to circulate as cash and was finally redeemed by the Bank in cash. At the same time, the public was assured by the Bank through the press and through editorial comment that the scrip "was as good as greenbacks".

To show clearly how the Bank regarded the scrip, we quote the following from a letter of March 16, 1933, to the

Deputy Comptroller of the Currency from Z. C. Patten, Conservator of the Bank. Mr. Patten was a director of the Bank. After referring to the issuance of the scrip, he stated:

> "Due to the uncertainties of the general situation, and realizing that if *cash* were paid for these purposes, much of it would have been hoarded and shipped out of town, the local banks decided to issue scrip instead of *paying out the cash*. However, in order to insure the free circulation of the scrip, the local banks agreed that each of them would *definitely secure it* and our attorneys stated that in view of the fact that we had been authorized to pay *cash*, that such security would be valid, as it was the nature of a loan, to be used for an emergency, and to prevent *the use of actual cash*. For the most part, the scrip went into the hands of wage earners and small salaried people, much of it finding its way into the hands of small retailers and will work a tremendous hardship upon a large number of people if the bank were not permitted to redeem it in cash." (Italics inserted.)

Thereupon he further states that the scrip was secured by "well-selected good notes", which were delivered to the First National Bank, Trustee. Thereupon, he also asks authority to redeem the scrip in cash and obtain the return of the security from the trustee (R. 72-73). *All of the foregoing was afterwards done.*

If the Bank had issued cash to the petitioners instead of adopting this circuitous arrangement,—in which the President of the petitioner Davenport Hosiery Mills actively participated as a director of the Bank,—there could be no denial of the depletion of the assets of the Bank. It is not denied that these petitioners have received benefits which other depositors less fortunately situated were not able to obtain. But the condition of the Bank at this time was such that it was afraid to deplete the relatively small amount of cash which it had on hand by paying those depositors in cash who presented checks for payrolls, etc. At this time, the Bank still hoped to reopen on March 14th and

hoped to obtain loans from the Reconstruction Finance Corporation or the Federal Reserve Bank in an amount sufficient to justify reopening. Therefore, the Bank devised the scheme of issuing scrip in lieu of cash. But in order to give the scrip the quality of a circulating medium at its full face value, the Bank depleted its assets to the extent of $250,097.69 by pledging securities of this value to the First National Bank as Trustee for the express purpose of fully satisfying in cash the scrip which it issued.

It is a fundamental rule of law that that which is illegal, if done directly, cannot be made legal by indirection. When the defendant presented its checks and obtained scrip therefor, which recited on its face

> "$1.00 of a deposit in the Chattanooga National Bank of Chattanooga, Tennessee, has been assigned by the depositor thereof to the bearer hereof",

and passed this scrip on to its employees at a full valuation of one hundred cents on the dollar, *it was not thereby attempting to assign an interest in its deposit as this deposit existed on March 1st*,—when the Bank was last open for business,—*but it passed on to the employees an interest in its deposits, which to the extent of the amount of scrip issued had become a secured deposit*—or, to more accurately state it, it was a deposit that the Bank had attempted to secure illegally—illegal, among other things, for the reason that the Bank had already committed acts of insolvency, and because the Bank was then insolvent and was attempting to give to these depositors advantages in the race for assets which other depositors not so fortunately situated could not enjoy.

A proper legal interpretation of the terms of the scrip certificates cannot be reached by a mere examination of the scrip itself. On the contrary, the scrip must be read and interpreted in the light of the trust indenture entered into with the First National Bank, under the terms of which the redemption of the scrip at its full face value in cash was assured.

THE "COROLLARY" QUESTION.

The petitioners deny that the principles of estoppel are involved in this case, and also that there is any basis for recovery of money had and received. These questions are discussed on pages 14 and 17, inclusive, of the petition. We will answer these questions together.

Section 91 of Title 12 classifies as "utterly null and void" all transfers of the notes, etc., of any national bank made after the commission of an act of insolvency, or in contemplation thereof and with a view to preventing the application of its assets in the manner prescribed by the Statute, or with a view to the preference of one creditor over another. It results, therefore, that the transfer of the securities to the First National Bank for the redemption of the scrip in cash was utterly null and void. The assignment of the defendant's interest in its supposedly secured deposit also becomes utterly null and void and therefore the holder of the scrip who presented it to the Bank for payment and who received payment at one hundred cents on the dollar, obtained, in the final analysis, money for the benefit of the petitioners, inasmuch as the petitioners profited out of this illegal transaction by satisfying their debts in full at the expense of other creditors of the Bank.

> "'Money paid' is a phrase used as equivalent to the phrase 'money paid by one for the use or benefit of another to a third party.'" *41 C. J. 12.*

Continuing the same text says:

> "One who has paid money for the use and benefit of another to a third party may recover from that other the money so paid, if such payment was made at that other's express request, or if he subsequently ratified it, or if, in the absence of such request or ratification, it was made under circumstances from which the law will imply an obligation to repay, even though there was no express promise to repay, the law implying such a promise. Where there is no request and the obligation to repay is implied solely in law, such obligation is said to be founded on a constructive contract or quasi con-

tract. Where there is an express request, or a ratification, the right of recovery is founded on contract, and is governed by the ordinary rules applicable to contracts implied in fact; nevertheless, since it is customary in common-law pleading to declare on such a payment in the same language as is used to declare on a payment made without such request, or indeed against the wish of defendant, such payment is commonly regarded as being embraced under the phrase 'money paid' and is here so treated."

In the instant case, the Bank in effect entered into a contract with the petitioners to issue scrip to it upon the presentation of its checks for pay rolls, and agreed to redeem the scrip in cash at their full face value, having prior thereto attempted to pledge its securities to the First National Bank for the redemption of the scrip.

"One who, under a contract subsequently rescinded or found unforceable, has made, for the benefit of the other contracting party, payments or disbursements to a third party, may recover such payments from the other contracting party." *41 C. J. 17.*

The implied contract between the Bank and the petitioners was unenforcible for the reason that the Bank, having prior to this time committed acts of insolvency, was not permitted legally to transfer its asssets as security for the payment of the scrip.

The implied contract for the redemption of the scrip in cash is evidenced by the face of the scrip itself. The concluding sentence of the scrip, after reciting that the Bank agrees to credit the account of the bearer in the Bank with the amount of the scrip upon presentation, is as follows:

"Any credit in said bank created by presentation of this assignment to the credit of bearer is subject, at the option of said bank, to the issuance of like assignments for a period of six months from the date hereof."

The only conclusion to draw from this language is that if the Bank did not exercise the option during the six months

period, it would redeem the scrip in cash during the period. At the end of the six months period the Bank had no option except to pay it in cash. The terms of the scrip itself, therefore, put the petitioners on notice that the Bank was agreeing to redeem the scrip in cash. In harmony with this provision on the face of the scrip is Paragraph 2 of the trust indenture entered into with the First National Bank:

> "The credits given upon the presentation of said certificates (scrip) may, at the option of said bank, during the period of six months from March 10, 1933, be satisfied by the issue of similar certificates and said securities are pledged as security that the final credits given for said certificates will be fully satisfied in cash."

Although this transaction is believed to be void in so far as creditors of the Bank are concerned, and in so far as any rights or obligations under the transaction are involved, yet the existence of this transaction as a factual circumstance under which payment was made in this case and the fact that payment was made pursuant to this arrangement and that the effect of this arrangement was a payment pursuant to the direction and request of the depositor made for his benefit, cannot be denied by the depositor inasmuch as the depositor accepted the benefits of the transaction and directed and permitted the Bank to make payments pursuant thereto. The depositor cannot, under these circumstances, repudiate the effect of this transaction which was to give it a preference.

It is said in 21 C. J. 1206:

> "Where one having the right to accept or reject a transaction takes and retains benefits thereunder, he ratifies the transaction, is bound by it and cannot avoid its obligation or effect by taking a position inconsistent therewith."

The petitioners in their brief insist that there can be no elements of estoppel in this case because the Bank knew as much as the defendants did with reference to the transaction. P. 15 and 16. This is not a contest between the

Bank and the petitioners, but it is a contest between the creditors of the Bank, represented by the Receiver, and the petitioners.

Certainly it cannot be claimed that the large number of creditors who were not permitted by the Bank to make withdrawals as these petitioners did were in any sense a party to these illegal transactions. They had no knowledge of the arrangements which the Bank had made for the benefit of the favored few.

As stated by the trial judge:

> "It is to be remembered that this contest is not between two parties in pari delicto. * * * The defendant in its transaction with the Bank was charged with a knowledge of the law and the rights of creditors in case of insolvency.
>
> "It results that on the one side we have the creditors who are innocent of wrongdoing and on the other side we have the defendant who participated in the unlawful transaction. Hence, the application of the doctrine of estoppel. Cf. Joy v. Godchaux, 35 Fed. (2d) 649.
>
> "The court is of the opinion that the doctrine of estoppel or waiver is the true rule for determination of this case. But if estoppel or waiver did not apply, the whole transaction was void in its incipiency and the defendant would be liable for money had and received." (R. 199)

It cannot for a moment be doubted that the real beneficiaries of this entire transaction were the petitioners. They owed bills to employees which normally would have been paid in cash. Cash was not available from the Bank. But the Bank worked out this arrangement whereby scrip (the payment of which in cash, at a later date, at its full value, was secured), would be accepted by the petitioners' employees *in lieu of cash*. It was so accepted. It passed from hand to hand as a medium of exchange. It was presented to the Bank and redeemed in cash at its full value. The parties who redeemed it are not now subject to identification. The petitioners stand as the unquestioned benefici-

aries of the entire arrangement. It is immaterial in the last analysis whether the petitioners received cash for their checks or received scrip, for the redemption of which, in cash, arrangements had already been made.

In *National Bank of Newport* v. *National Herkimer County Bank*, 225 U S. 178, Justice Hughes, later Chief Justice, said:

> "To constitute a preference, it is not necessary that the transfer be made directly to the creditor. *It may be made to another for his benefit.* If the bankrupt has made a transfer of his property, the effect of which is to enable one of his creditors to obtain a greater percentage of his debt than another creditor of the same class, *circuity of arrangement* will not avail to save it. A 'transfer' includes 'the sale and every other and different mode of disposing of or parting with property, or the possession of property, absolutely or conditionally, as a payment, pledge, mortgage, gift or security.' It is not the mere form or method of the transaction that the act condemns, but the appropriation by the insolvent debtor of a portion of his property to the payment of a creditor's claim, so that thereby the estate is depleted and the creditor obtains an advantage over other creditors." (P. 184)

In *Second National Bank of Toledo* v. *M. Samuel & Sons*, 12 Fed. (2d) 963, it is said:

> "From the days of Lord Mansfield's decision in Moses v. Macferlan, 2 Burr. 1065, 97 Eng. Reprint 676, decided in 1760, the common-law courts have recognized the right to sue in the equitable action of indebitatus assumpsit to recover money paid by mistake, or if 'the defendant upon the circumstances of the case is obliged by the ties of natural justice and equity to refund the money'. And as stated in Mr. Woodward's work on Quasi Contracts, Sec. 3, quasi contractual obligations are defined as 'arising without reference to the assent of the obligor, from the receipt of a benefit the retention of which is unjust, and requiring the obligor to make restitution.' 'They rest solely upon the universally recognized moral obligation

of one who has received a benefit, the retention of which would be unjust, to make restitution.' Id., Sec. 6".

"The defendant has entered into no contract with the plaintiff herein. The contract appears to have been with the Irving National Bank, which issued the letter of credit. The defendant procured the Irving National Bank to issue the letter of credit, and it, and not the defendant, was therefore, the promisor. While no contractual relation exists between the plaintiff and the defendant, the defendant has assumed a quasi contractual relation with the plaintiff. That relationship grows out of the fact that the defendant received a benefit the retention of which would work a serious injustice to the plaintiff. And this quasi contractual obligation is imposed without reference to the obligor's assent. It is essential to the existence of a quasi contractual obligation that it be shown: (1) That the defendant has received a benefit from the plaintiff. (2) That the retention of the benefit by the defendant is inequitable." (P. 967)

Assuming it to be true that no specific contract existed between the petitioners and the Bank, certainly it cannot be denied that the necessary elements of a quasi-contractual obligation existed. The petitioners,—as the result of the scheme devised by the Bank,—have unquestionably received the benefit of discharging in full the claims of their employees. The retention of this benefit unquestionably is inequitable and unfair because it gives these petitioners an advantage over other depositors, all of whom the respondent represents.

The petitioners should be required to make restitution for the unlawful advantage which they have obtained over other creditors. The Restatement of the Law, in the Volume on Restitution, at page 196, Sec. 48, says:

"Unless otherwise agreed and except as stated in Sec. 52, a person is entitled to restitution for a benefit which he has conferred upon another as the whole or part of his performance of a contract with another, under the erroneous belief induced by a mistake of law, either shared by both or known to the other, that the manifested basic purpose of the contract can be carried

> out or is thereby achieved. If the purpose fails in part and the benefit is severable, there can be restitution pro tanto."

In reply to the narrow view which is taken of respondent's substantive rights with respect to a preference, we wish further to discuss the case of *National Bank of Newport* v. *National Herkimer County Bank,* 225 U. S. 178, and its proper application to the case at bar.

In that case the National Herkimer County Bank was a creditor of the Newport Knitting Company by reason of a note upon which the Titus Sheard Company was secondarily liable as an endorser. The Titus Sheard Company paid the National Herkimer County Bank in full and claimed subrogation, or reimbursement, from the bankrupt Newport Knitting Company. To effect this claim for reimbursement the Titus Sheard Company set up on its books a debit in its favor upon an account which it owed to the bankrupt, this debit being in the full amount of its payment to the National Herkimer County Bank, and the bankrupt, Newport Knitting Company, set up a corresponding credit in favor of the Titus Sheard Company. These two bookkeeping entries were made without the knowledge of the National Herkimer County Bank, which was the creditor to whom the alleged preference was made.

The Trustee in Bankruptcy of the Newport Knitting Company sued the National Herkimer County Bank, claiming that the setting up of the credit in favor of Titus Sheard Company was an intermediate step in the granting of a preference to the National Herkimer County Bank, which was paid in full by Titus Sheard Company. The theory of the Trustee in Bankruptcy was that the credit in favor of the Titus Sheard Company was a depletion of the assets of the bankrupt, and that this depletion of the bankrupt's assets indirectly resulted in the benefit to the National Herkimer County Bank through the payment which was made to the Bank by the Titus Sheard Company in exchange for the credit in its favor against the bankrupt.

The Court held that since the Titus Sheard Company had acted on its own behalf, and that there was no arrangement between the bankrupt and the National Herkimer County Bank for indirectly paying the National Herkimer County Bank by means of the credit to Titus Sheard Company—the National Herkimer County Bank, in fact, knowing nothing at all about any depletion of assets of the bankrupt's estate —the National Herkimer County Bank could not be construed to have received a preference.

The payment to the National Herkimer County Bank by the Titus Sheard Company was for the purpose of relieving the Titus Sheard Company of its endorsement liability to the National Herkimer County Bank. The National Herkimer County Bank could have collected this from Titus Sheard Company, regardless of whether the Titus Sheard Company received any reimbursement from the bankrupt.

The Court said that the preference was in the setting up of the credit to Titus Sheard Company, and that this credit should be rescinded, which would then leave the estate of the bankrupt in exactly the same condition that it was before the credit was set up.

The Court further said, however, that if there had been an arrangement between the bankrupt and its creditor, the National Herkimer County Bank, to prefer the National Herkimer County Bank by means of a credit to Titus Sheard Company which was to have been transferred to the National Herkimer County Bank, then, notwithstanding the "circuity of arrangement", the Trustee in Bankruptcy might have recovered the preference from the National Herkimer County Bank. The statement of the Court on page 184 is as follows:

> "if an insolvent debtor arranges to pay a favored creditor through the disposition of such an account, to the depletion of his estate, it must be regarded as equally a preference, whether he procures the payment to be made on his behalf by the debtor in the account—the same to constitute a payment in whole or part of the latter's debt—or he collects the amount and pays it over to his creditor directly."

It is submitted that the hypothetical case of Justice Hughes is analogous in principle to the present case. This hypothetical case contemplated a situation where the bankrupt should agree with its creditor, the National Herkimer County Bank, to prefer it by paying assets to a person indebted jointly with the bankrupt to the National Herkimer County Bank, which debtor would, in turn, pay the debt of himself and the bankrupt to the National Herkimer County Bank, thus paying off the National Herkimer County Bank's claim against the bankrupt in full.

In the case at bar the Chattanooga National Bank agreed, in effect, with the Davenport Hosiery Mills and the United Hosiery Mills, that it would pay them in cash in advance of its other creditors, by paying the employees of these companies, but these payments were only to be made to such employees of the Mills as should first pass the benefit on to the Mills by discharging their claims against the Mills.

The difference between this case and the hypothetical case supposed by Justice Hughes is that in the hypothetical case the assets of the insolvent are delivered to the third person with a mere agreement that the third person would discharge the insolvent's debt to his creditor in full, whereas in the case at bar the parties did not trust the third party to that extent; they required that the third party first discharge the insolvent's liability to his creditor and then come and get the cash.

To phrase the problem in another way, we may say that the Chattanooga National Bank gave to the Davenport Hosiery Mills and the United Hosiery Mills a *power* to realize in full upon their deposit claims against the Bank. This power was to be exercised by designating a creditor of the Mills to whom the Bank agreed to pay cash. The Bank's agreement to pay cash was secured by a pledge of its assets.

We do not see that it is material whether the bank fulfilled its obligation to pay the persons designated by the Mills before or after the Mills reaped the benefit of the exercise of this power. Since the entire transaction was carried out

pursuant to an original written agreement to give a preference of which the Mills were to reap the benefit, the ultimate consummation of this agreement to give a preference must be related to the original agreement of which it was merely the conclusion.

This original agreement to give a preference clearly shows that the creditor of the Bank who was to receive the scrip and use it to discharge his indebtedness was the beneficiary of the ultimate cash payment then agreed to be made. The execution of the illegal agreement was in accordance with its terms and intent, and the defendants actually received the intended benefit therefrom.

The curious reasoning of the petitioners is that it was unlawful for the Mills to receive the benefit that they derived from this illegal agreement. Therefore, say the petitioners, the court should conclude that the benefit received by them was void, and, therefore, they did not receive any benefit, and, therefore, respondent has no cause of action against petitioners.

According to this line of reasoning, since all preferential transfers are void, they are non-existent and no suits of any kind could ever be predicated upon them. We respectfully submit that if preferential transfers and liens are "void", it is a character of voidness which can only be taken advantage of by the creditors of a bank for whose benefit they are made void. A preferred creditor can hardly be heard to rely upon the illegality of the preference to support his protestations that he received nothing. Nor should he be heard to say that payments of cash made to others pursuant to a lien given by the Bank for his benefit were not in fact made pursuant to such lien because no such lien ever existed, it being declared void by statute.

We submit that the word "void" as used in the statute means "void as to creditors", not void as to the person receiving benefits under the voided transaction.

The petitioners also seek to take advantage of the fact that the pledge of assets by the Bank was *ultra vires* apart

from insolvency. We doubt if under any circumstances the petitioners would be in a position to take advantage of the *ultra vires* character of the act. Certainly, they could not do so and retain the benefits of the transaction which they are attacking.

CONCLUSION.

In its final analysis the position of the petitioners is this: They admit that the scheme under attack in these suits, devised by the Bank after the commission of an act of insolvency, and while insolvent, inured directly to their own benefit. The petitioners admit that a portion of the scheme, —that is, the pledge of the assets to the First National Bank, Trustee, to secure the payment of the scrip,—was illegal, but, say the petitioners, "We had a perfectly legal right to assign all or any portion of our deposit to any third person and, having this right, this portion of the transaction should stand stripped of the illegal pledge of assets." But it was not this type of assignment that these petitioners attempted to make. The assignment which they attempted to make was an assignment of an interest in their deposit secured by the pledge of assets to the extent of the assignments. It was one single illegal transaction, directly violative of Section 91 of Title 12, U. S. C., and classified by this Section as "utterly null and void".

The petitioners can hardly deny that if their checks presented to the bank had been paid all in money instead of mostly in scrip and partially in money, they would be forced to make restitution. We submit there is no difference in principle between the withdrawal of money and the withdrawal of assets having an equal or greater money value.

As said by Chief Justice Hughes in *National Bank of Newport* v. *National Herkimer County Bank*, *supra*, "circuity of arrangement will not avail to save it."

Respectfully submitted,

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